FILED
AUG 25 1941
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 547

314-660

BENJAMIN MAHLER and JULIA F. MAHLER,
Petitioners,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

HARRY FRIEDMAN,
Counsel for Petitioners.

THE COURT PRESS, N. Y. C.

INDEX.

PETITION.

PAGE

Petition 1

Opinion Below 2

Questions Presented 2

Jurisdiction 3

Statutes Involved 3

Statement 4

Statement of Facts Relating to Worthlessness of the Common Stock of the Middle West Utilities Company 6

Specification of Errors to Be Urged 10

Reasons for Granting the Writ 11

BRIEF IN SUPPORT OF PETITION.

Opinion Below 13

Jurisdiction 13

Statement of the Case, Questions Presented, Statutes Involved, Etc. 13

Summary of Argument 13

Argument 16

I—The Board decision and the Circuit Court's affirmance was predicated on an issue not raised by the pleadings or litigated and on which petitioners had had no opportunity to offer evidence and as a result, petitioners were deprived of a fair and full trial 16

PAGE

II—The holding that in sustaining a deficiency the Board may consider and decide an issue not presented or litigated, is contrary to the holding of this Court in numerous decided cases 19

III—The failure to afford petitioners an opportunity to offer proof as to 1932 values, materially and injuriously affected the substantiality of the evidence necessary to sustain the finding of 1932 worthlessness 21

IV—The Circuit Court's holding that a taxpayer must under all circumstances establish before the Board every essential fact involving in a deduction, is contrary to orderly procedure, imposes an undue burden on taxpayers, and presents a question that affects the public interest 24

Conclusion 25

Appendix A 27

CITATIONS.

Cases:

Britt, Carl M., 43 B. T. A. 254 at 260 24

Burdan, John W. v. *Commissioner*, 106 Fed. (2) 207 23

Chicago & N. W. Ry. Co. v. *Commissioner*, 114 Fed. (2) 882 at 889 24

Clifford v. *Commissioner*, 309 U. S. 331 .....15, 20

Dolores Crabb and others v. *Commissioner*, C. C. A., 5th Circuit, promulgated July 25, 1941 20

General Utilities & Holding Co. v. *Helvering*, 296 U. S. 200 .....11, 14, 16, 19, 20

Gerber, The John Co., 44 B. T. A. .....

PAGE

Helvering v. *Tex-Penn Oil Co.*, 300 U. S. 481 ..... 11, 12, 15, 19, 20

Helvering v. *Wood*, 309 U. S. 344 at 349 ..... 12, 14, 19, 20

Hormel v. *Helvering*, 61 S. C. 719 ..... 12, 14, 15, 19, 20, 23

Horning, George H. v. *Commissioner*, 35 B. T. A. 897 ..... 5, 19

Jones A. R. Oil etc. v. *Commissioner*, 114 Fed. (2) 642 at 646 23

Knowlton Moore v. *U. S.*, decided June 24, 1941, Fed. (2) 25

Memphis Cotton Oil, 288 U. S. 62 18

Moise v. *Burnet*, 52 Fed. (2) 1071 ..... 18, 24

Morton, Sterling, 38 B. T. A. 1270 23

Peabody, Mary S., 38 B. T. A. 1086 5

Richter, O. G. v. *Helvering*, 61 S. C. 723 ..... 20, 23

Seerley, John J. v. *Commissioner*, 43 B. T. A. 50 24

Taylor v. *Commissioner*, 70 Fed. (2d) 619, 621, affirmed 293 U. S. 507 ..... 18, 24

Tex-Penn Oil Co. v. *Commissioner*, 83 Fed. (2) 518, 524 24

U. S. v. *Factors Finance*, 288 U. S. 289 18

Statutes:

Judicial Code as amended by the Act of February 13, 1925:
Section 240(a) 3, 13

Revenue Act of 1934:
Section 23 27

Regulations 86:
Article 23(e)-4 27

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. .

BENJAMIN MAHLER and JULIA F. MAHLER,
Petitioners,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Petition.

Petitioners, Benjamin Mahler and Julia F. Mahler, pray that a writ of certiorari issue to review that part of the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above cause on May 26, 1941, which affirmed the decision of the United States Board of Tax Appeals. The part of the decision sought to be reviewed relates to the worthlessness of the common stock of the Middle West Utilities Co. The Circuit Court of Appeals reversed the Board with respect to the year in which the preferred stock of the Middle West Utilities Company became worthless, and in connection therewith, petitioners seek no review.

Opinion Below.

The decision of the Circuit Court of Appeals is reported in 119 Fed. (2d) 869. The decision of the Board of Tax Appeals so affirmed and reversed by the Circuit Court, is in the form of a memorandum opinion and is not officially reported. It is set forth in full in the transcript of record filed with the Circuit Court at pages 35 to 58 inclusive.

Questions Presented.

1. Whether the decisions below were not in violation of due process of law, in that both the Board of Tax Appeals and the Circuit Court of Appeals for the Second Circuit decided the case upon an issue not raised and not tried, and without affording petitioners an opportunity to present evidence thereon.

2. Whether the Board and the Court below did not err in deciding that the common stock of the Middle West Utilities Company was worthless in 1932 when that issue was neither raised by the Commissioner of Internal Revenue, not litigated before the Board, and where the deficiency notice conceded that the common stock had value at least to December 31, 1935.

3. Whether in light of (a) the Commissioner's holding in the deficiency notice that the stock of the Middle West Utilities Co. had value up to the end of 1935; (b) the fact that in other reported proceedings the Commissioner was contesting other taxpayers' claims of 1932 worthlessness, and (c) the failure of the Commissioner at any time during the hearing to modify his position that the stock had not become worthless

by December 31, 1935, petitioners were not misled in assuming that no facts or evidence as to existence of value prior to 1934 need be introduced so that a decision based solely on evidence introduced by petitioners in an attempt to establish the occurrence of worthlessness in 1934 resulted in petitioners being deprived of a fair trial.

4. Whether there was any substantial legal evidence to support the Board's finding that Middle West common stock became worthless in 1932.

5. Whether the Board, having found, as contended for by petitioners, that Middle West stock was worthless in 1934, contrary to the Commissioner's determination that no such worthlessness had occurred prior to 1936, judgment should not be entered for petitioners allowing the loss deduction as claimed in 1934.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 26, 1941. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Statutes Involved.

The statutes involved will be found in Appendix A, *infra*, page 27.

Statement.

The facts deemed material to this application are as follows:

Petitioners were the owners of both common and preferred stock of Middle West. They deducted the cost of the stock in their 1934 tax return as a loss due to worthlessness. Upon examination of petitioners' return, the Government investigator indicated that his instructions were that the stock was not yet worthless. Thereupon petitioner, Benjamin Mahler, communicated with respondent requesting a conference to fix, if possible, the year when respondent deemed the stock to have become worthless. Under date of January 19, 1937, respondent replied (R., fols. 374-5) that so far as the years prior to 1936 are concerned, "the Bureau holds that the stock * * * did not become worthless during or prior to the year 1935", and that so far as the year 1936 is concerned, it is "unable to advise * * * at this time just what position will be taken by the Bureau * * *" (R., fol. 378).

Thereafter and on February 16, 1937, respondent issued his deficiency notice confirming the holding set forth in letter of January 19, 1937 that the Middle West stock "did not become worthless during or prior to the year 1935". From this determination, petitioners on March 17, 1937 appealed to the Board, alleging that the stock became worthless in 1934 and that the Commissioner erred in not so holding. Respondent denied these allegations. The proceeding went to trial before a member of the Board on November 15, 1938.

Shortly after the filing of the Board petition in this proceeding and on April 20, 1937, the Board

promulgated its opinion in *George H. Horning*, 35 B. T. A. 897, wherein it sustained the Commissioner in holding that Middle West stock did not become worthless in 1932. Thereafter, and on November 4, 1938, eleven days prior to the date of the hearing in this proceeding, the Board promulgated its opinion in *Mary S. Peabody*, 38 B. T. A. 1086, reversing the Commissioner in his determination that Middle West stock was not worthless in 1932. At the time of petitioners' trial the Commissioner had not announced his acquiescence in this decision and neither at the hearing nor at any time thereafter did the Commissioner move either to modify the deficiency determination that the Middle West stock possessed value throughout the years 1932 to 1935, or to otherwise amend his pleading to allege worthlessness prior to 1934. Petitioners went to trial on the assumption that on the question of worthlessness, the only burden resting on them was to establish absence of value in 1934, and at no time during the proceeding did they receive any indication or intimation from the Board that the existence of value prior to 1934 (already determined in the deficiency notice) must also be established. Petitioners accordingly offered evidence, limited, as far as possible, to the issue of worthlessness in 1934.

Thereafter, the Board rendered its opinion holding that the stock was actually worthless in 1934, but that nevertheless petitioners were not entitled to the loss deduction because, in its opinion, the stock became worthless in 1932. It denied a re-consideration requested, among other things, on the ground that petitioners had not been apprised that worthlessness in 1932 or any year prior to 1934 was in issue, and that petitioners had not therefore had an opportunity to

offer evidence on that issue. The Board thereupon redetermined the deficiency.

Petitioners appealed from such redetermination to the United States Circuit Court of Appeals, Second Circuit, both on the ground that the Board was not warranted in considering or deciding the question of 1932 worthlessness as well as on the ground that there was no substantial evidence in the record to sustain the Board's finding of 1932 worthlessness. Neither in the deficiency notice, the petition filed with the Board, the trial before the Board, nor in the proceedings before the Circuit Court, was there any distinction drawn between the common and the preferred stock.

The Circuit Court held that the Board committed no error in rendering its decision predicated on 1932 worthlessness. On the question of substantial evidence, it held that the Board erred in finding that the preferred stock became worthless in 1932, but that it did not err in finding that the common stock became worthless in 1932 since reserves set up by accountants for the receiver as of December 31, 1932 wiped out all book equity for such common stock.

Statement of Facts Relating to Worthlessness of the Common Stock of the Middle West Utilities Company.

Middle West Utilities Company was a gigantic public utilities holding company. Its assets consisted almost wholly of investments in and advances to numerous subsidiary corporations of which some were subholding companies and others operating companies. On April 15, 1932 a federal district court in Illinois appointed equity receivers for Middle West on the ground of its inability to finance its obligations. At

that time the book value of the company's assets was over $308,000,000 with liabilities of approximately $73,000,000. Thus the books disclosed an equity for stockholder interests of more than $235,000,000. The stock outstanding was approximately 607,400 shares of preferred with a par value of $100 a share and 15,942,113 shares of common without par value but with a stated value of $10 a share.

Following the receivership of the parent company several of its subsidiaries went into receivership or bankruptcy in 1932 and the early months of 1933. By June, 1933, Middle West's investment in subsidiaries already in receivership was approximately $100,000,000. If the entire investment of Middle West in the subsidiaries placed in receivership in 1932 and 1933 were deducted from the book value of the Middle West assets the book value remaining would be over $200,000,000 as against $73,000,000 liabilities plus $60,740,000 preferred stock. None of the subsidiaries placed in receivership were reorganized or plans for reorganization filed prior to 1934.

Shortly after they were appointed, the receivers, pursuant to authority granted, retained Arthur Andersen & Company, accountants and auditors, to make an examination of Middle West and to prepare an annual audit of that company for the year 1932 (Ex. 17, p. 9). Under date of June 5, 1933, the receivers submitted their first report (Ex. 17) wherein they indicated that in accordance with the recommendations of the accountants (attached to and made a part of their report), they had caused reserves to be set up and charges made to surplus to provide against all possible losses on investments both in companies in receivership *as well as in those not in receivership.* After setting up all reserves for losses including those

not yet sustained or known but which might in future years be sustained, the book value remaining still totaled over $149,000,000 as against the liabilities of $73,000,000, and $60,740,000 preferred stock.

In the said report of June 5, 1933, the receivers indicated that they had not yet attempted to make an appraisal of the value of the Middle West assets, although they appreciated the justifiable desire of creditors and security holders to be informed as to the present and anticipated value of such assets. The receivers in their report stated further that——

> "very substantial values remain, chiefly in Middle West's control through common stock ownership of sizeable operating utility property well located throughout diversified territories" (Ex. 17, p. 1).

During Middle West's receivership several groups of interested parties also prepared reports of the financial condition and future prospects of the company. In the latter part of 1932 a committee for common stockholders sent out an optimistic report. Even more optimistic was a report by a committee for preferred stockholders under date of July 10, 1933.

The only pessimistic report was one issued in November, 1932 by a committee for the noteholders but that report stated that it "does not pretend to present the 'fair and reasonable' value of the assets".

In June 1934 the accountants submitted to the receivers a report as of December 31, 1933. This showed $205,000,000 had been written off of the Middle West Company's investments in subsidiaries both those in receivership as well as those not in receivership to provide for possible and contingent losses.

The receivership continued until July 24, 1934, when the receivers were superseded by a trustee appointed in reorganization proceedings under Section 77 B of the Bankruptcy Act.

In October 1934 a plan of reorganization was filed by Middle West Creditors. Thereafter and early in 1935 hearings were had before the bankruptcy court for the purpose of passing upon the fairness of the plan of reorganization and the solvency of the Middle West. At one of such hearings, Mr. Taylor, the attorney for the common Stockholders' Protective Committee, stated in open court that, on behalf of the common stockholders, he would no longer oppose Middle West reorganization although up to then such opposition had been made in the belief that additional funds could be procured either from private or public sources (Ex. 3B attached to deposition of Walter Shaw, pp. 5 and 6).

An appraisal made as of July 23, 1934, pursuant to court order, found that the liabilities exceeded the assets by more than $10,000,000. On November 27, 1935, the District Court confirmed a plan of reorganization. The court found specifically that as of July 23, 1934, Middle West was insolvent and that no equity existed for either preferred or common stockholders and that hence acceptance by the stockholders was not required for the confirmation of the plan. Nevertheless the plan provided for the issuance of new stock and warrants to the old stockholders on a certain nominal exchange basis. The record shows (fol. 290) that at the date of the hearing petitioners had not surrendered their old stock.

Specification of Errors to Be Urged.

1. The Court erred in holding that the Board was warranted in considering and deciding an issue not raised in the deficiency notice or litigated before the Board.

2. The Court erred in holding that petitioners were required to establish the existence of value of Middle West stock for years prior to 1934, when the Commissioner in his deficiency notice made a determination that that stock possessed value to the end of 1935.

3. The Court erred in not holding that the Board committed error in refusing to grant petitioners' motion for a reconsideration of the issue covering worthlessness prior to 1934.

4. The Court erred in not holding that the Board committed error in failing to reopen the proceeding for the introduction of evidence covering worthlessness prior to 1934.

5. The Court erred in not holding that in light of all the circumstances, petitioners did not receive a full and fair trial.

6. The Court erred in not holding that in view of the language of the deficiency determination holding that Middle West stock did not become worthless during or prior to 1934 and the basis on which trial of the proceedings was had, the finding of the Board that the stock was worthless in 1934 should have required judgment for petitioners.

7. The Court erred in holding that there was substantial evidence to support the Board's finding of

worthlessness of the common stock of the Middle West Utilities Co.

8. The Court erred in holding that the absence of book value for the common stock as shown in the statement of the accountants for the Receiver is sufficient to sustain the Board's finding of worthlessness of such common stock.

9. The Court erred in treating the reserves set up by such accountants to cover possible future losses in solvent companies as the equivalent of the destruction of present values.

10. The Court erred in not holding that even if Middle West's entire investment in companies in receivership were all eliminated the common stock would still have a book value as at the end of 1933.

Reasons for Granting the Writ.

1. Petitioners were denied a fair trial as both the Board of Tax Appeals and the Circuit Court of Appeals had based their decisions on a point not presented or argued by the litigants in the trial court, and which petitioners had never had an opportunity to meet by the production of evidence.

2. The holding of the court below that the Board may consider and decide a case upon an issue not raised or litigated before it and may do so even where the issue was waived or conceded by the Commissioner goes contrary to and is in conflict with the decisions of this court involving a somewhat similar question. *General Utilities & Holding Co.* v. *Helvering,* 296 U. S. 200; *Helvering* v. *Tex-Penn. Oil Co.,*

300 U. S. 481; *Helvering* v. *Wood*, 309 U. S. 344 at 349 and *Hormel* v. *Helvering*, 61 S. C. 719.

3. The question whether the Board of Tax Appeals may predicate its decision on an issue not raised or litigated, and on which taxpayers had had no opportunity to present evidence, on the theory that such taxpayers must always and under all circumstances prove all essential facts necessary to sustain a deduction, is one that to a great extent affects the public interest in view of the innumerable appeals taken to the Board, and the frequency with which this question would naturally arise.

August 23, 1941.

HARRY FRIEDMAN,
538 Munsey Building,
Washington, D. C.,
Counsel for Petitioners.

BRIEF IN SUPPORT OF PETITION.

Opinion Below.

The decision of the Circuit Court of Appeals is reported in 119 Fed. (2d) 869. The decision of the Board of Tax Appeals so affirmed and reversed by the Circuit Court, is in the form of a memorandum opinion and is not officially reported. It is set forth in full in the transcript of record filed with the Circuit Court at pages 35 to 58 inclusive.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 26, 1941. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Statement of the Case, Questions Presented, Statutes Involved, Etc.

The statement of the case, the questions presented, Specification of Errors to be urged have been set forth in the petition. The statutes involved are set forth in the Appendix (*infra*, p. 27).

Summary of Argument.

The decisions against the petitioners involving 1932 worthlessness did not meet the ends of justice or the requirement of due process, since they were based on

an issue not raised by the pleadings nor litigated and were made without affording the petitioners an opportunity to present evidence.

The deficiency notice held that the common stock of the Middle West Utilities Company had not become worthless prior to December 31, 1935. The petitioners claimed the stock was worthless in 1934 or 1935. The issue tried before the Board was therefore whether the common stock became worthless in either of these two years or continued to possess value to the end of 1935. No evidence was offered by the petitioners or the respondent on the question of the worthlessness of the stock prior to 1934 since the Commissioner's deficiency notice had definitely eliminated the necessity for such evidence. The Board found that the common stock was worthless in 1934, but decided against the petitioners on the ground that the stock became worthless in 1932. The decision of the case was thus made without having given petitioners an opportunity to present evidence pertaining to 1932 worthlessness, denied to them a fair trial and was in violation of the spirit underlying the Constitutional requirement of due process of law. (*General Utilities*, 296 U. S. 200, 56 S. C. 185; *Helvering* v. *Wood*, 309 U. S. 344, 60 S. C. 551; and *Hormel* v. *Commissioner*, 61 S. C. 719.)

The determination of the court below that the Board was justified in deciding that the common stock was worthless prior to 1934 even though that issue was not raised by the pleadings was based upon a number of cases where the denial of deductions set forth in the deficiency notices was not on specific and restricted grounds. Those cases are inapposite, for here the Commissioner's denial was upon the specific ground that the common stock of the

Middle West Utilities Company had value at least until December 31, 1935. In the absence of an amendment to the deficiency notice or an affirmative pleading in the answer (neither present here) it became unnecessary for petitioners to prove that the stock had value at the beginning of the taxable year 1934, the first year in which the loss deduction was claimed.

The procedure followed by the Board and the Court below in this proceeding is in direct conflict with the principles announced by this court in *Tex-Penn Oil Co.*, 300 U. S. 481, wherein this court "declined to consider the newly presented question" which "had not been raised by the Commissioner either in his notice of tax deficiency or in his appearance before the Board of Tax Appeals" and in *Hormel* v. *Helvering*, 61 S. C. 719, in which this Court held that litigants must "have the opportunity to offer all the evidence they believe relevant to the issues", and *Clifford* v. *Commissioner*, 309 U. S. 331, which held that "however remote may be petitioners' chances" to establish facts connected with the new issue, nevertheless they should have been afforded an opportunity to present evidence on such issue.

The Circuit Court's holding as to the burden of proof that rests upon petitioners establishes a rule of procedure which affects the public interest, which is unduly onerous and which is contrary to all principles of equity and fairness. "Rules of practice and procedure are devised to promote the ends of justice, not to defeat them." *Hormel* v. *Helvering, supra.*

Argument.

I.

The Board decision and the Circuit Court's affirmance was predicated on an issue not raised by the pleadings or litigated and on which petitioners had had no opportunity to offer evidence and as a result, petitioners were deprived of a fair and full trial.

Firmly imbeded in our system of jurisprudence is the principle that no litigant is to be deprived of the opportunity to offer before a trial body all the evidence he deems relevant to the issues presented, and that such litigant may not be surprised by a decision on an issue upon which he had had no opportunity to introduce evidence. (*General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206.) This principle has been violated in the instant proceeding and, as a result, petitioners have been denied a fair trial.

Petitioners had deducted in their 1934 return a loss sustained on account of the worthlessness of the common and preferred stock of Middle West. The Commissioner disallowed the deduction, making a determination that the stock had not become worthless prior to December 31, 1935. Petitioners appealed to the Board and in the course of time went to trial. Neither during the intervening period, nor at any time during the course of proceeding did the Commissioner amend his pleading or otherwise move to allege worthlessness prior to 1934. Petitioners proceeded with the trial on the assumption that the stock concededly possessed value up to 1934 and that the only question (in connection with worthlessness) was whether such stock became worthless in 1934 (or in the alternative in 1935) rather than continuing to

possess value to the end of 1935, as determined by the Commissioner. This burden they met and the Board found that the stock was worthless in 1934.

Neither during the course of the trial nor at any time prior to the promulgation of its opinion did the Board indicate that the question of worthlessness prior to 1934 might be in issue or should receive consideration from petitioners. To the surprise of petitioners, the Board, although conceding that petitioners had established the worthlessness of the stock in 1934, nevertheless sustained the disallowance because it found that the stock both common and preferred, had become worthless in 1932. Petitioners' motion to reconsider the question of 1932 worthlessness because that point had not been put in issue, was denied by the Board. An appeal to the Circuit Court followed.

In the appeal to the Circuit Court, petitioners contended that the Board had committed error in thus passing on and deciding an issue which had not been presented or litigated. The Circuit Court refused to reverse, holding that, based on various decisions, the Board was warranted in deciding the issue of 1932 worthlessness although such issue had never been raised.

It may be conceded that the decisions referred to by the Circuit Court, apply in instances where the deficiency determination is predicated either on general grounds, or even on a single but unrestricted ground. Thus in a case of stock worthlessness, if the Commissioner's deficiency notice were to read that no loss had been sustained, concededly and because the determination was on general grounds, the taxpayer would under this rule, be required to establish every element involved in the determination of worthlessness, including cost, existence of value prior to, and cessation of value during, the taxable year. So

also, if the deficiency notice were to merely state that cost had not been established the burden would, under this rule, still be on the taxpayer to establish the existence of value before, and loss of value during, the taxable year in addition to establishing the cost or other basis of the stock. Cf. *U. S.* v. *Factors Finance,* 288 U. S. 289; and *Memphis Cotton Oil,* 288 U. S. 62; for the distinction between general and specific allegations.

It must be self evident however, that the cases relied on by the Circuit Court have no application in those situations where the Commissioner has either conceded one or more of these elements, or has otherwise by his action led the taxpayer to believe that no proof of the existence of such element will be required. Thus, and again taking a case of stock worthlessness, if the deficiency notice were to hold that while cost had been satisfactorily established, worthlessness had not, could it be presumed in the absence of any amendment to the deficiency notice, that that taxpayer must, at the trial of the proceeding, nevertheless offer proof of the cost of the stock in addition to proof or worthlessness!

Petitioners in the instant proceeding are in the last instanced category. Respondent's determination, which was *prima facie* correct and binding on both parties, was "that the stock did not become worthless during or prior to the year 1935". This was not only a determination that the stock was not worthless in 1934, but was equally a determination that the stock possessed value prior to 1934 including the year 1932. (*Taylor* v. *Commissioner,* 70 Fed. (2) 619, 621 affirmed 293 U. S. 507; *Moise* v. *Burnet,* 52 Fed. (2) 1071.) The Commissioner never modified this de-

termination and at the time the trial of this proceeding was had, it was public knowledge that he was before the Board opposing a contention that the stock became worthless in 1932. (*Geo. H. Horning* v. *Commissioner*, 35 B. T. A. 897).

In light of all these circumstances, it can not in fairness and justice be held that the general rule pertaining to a taxpayer's burden of proof required petitioners to submit evidence establishing that Middle West stock possessed value in 1932 and prior to 1934.

II.

The holding that in sustaining a deficiency the Board may consider and decide an issue not presented or litigated, is contrary to the holding of this Court in numerous decided cases.

This court has, in numerous tax cases, had occasion to consider issues raised in the appellate court and not previously presented to the trial body. One of the early cases where such a situation arose was *General Utilities & Holding Co.* v. *Helvering*, 296 U. S. 200. It was there held that Circuit Court of Appeals had erred in considering a contention not previously presented to, or ruled on, by the Board of Tax Appeals. This was followed by *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, where this court "declined to consider the newly presented question"—which "had not been raised by the Commissioner either in his notice of tax deficiency or in his appearance before the Board of Tax Appeals". To the same effect was the holding in *Helvering* v. *Wood*, 309 U. S. 344 at 349.

Although this court in *Hormel* v. *Helvering*, 61 S. C. 719, seemed to have departed from its earlier holding

of not considering new issues in the appellate court by giving consideration to a new issue raised before it for the first time, this departure was more apparent than real. The court in the *Hormel* case discusses the question at length, pointing out that new issues would be considered only where they constitute questions of law and where a miscarriage of justice might otherwise result. The court was careful to re-affirm its adherence to the principle that litigants must "have the opportunity to offer all the evidence they believe relevant to the issues"—and added that its "recognition of this general principle has caused (the Court) to say on a number of occasions that the reviewing court should pass by, without decision, questions which were not urged before the Board of Tax Appeals". A similar opportunity to submit evidence was given in the case of *O. G. Richter* v. *Helvering,* 61 S. C. 723.

In the *Wood* case the Commissioner had waived reliance on Section 22(a); in the *Tex-Penn Oil Co.* case he had failed to urge a certain issue in the lower court; and in the *General Utilities* case, he had specifically waived the point later urged. Because of these reasons, this Court, in all those cases held that the issues so waived or deliberately not raised below, could not be resorted to thereafter. On the other hand, because reliance on Section 22 (a) was not waived in the *Hormel* case, and the availability of the issue not realized until the promulgation of the *Clifford* decision, consideration of that issue in the appellate court, was in the *Hormel* case, permitted. But even then the case was remitted to the Board in order that the taxpayer might have an opportunity to offer evidence on the new issue "however remote may be his chance to take his case out of the Clifford rule". See also decision of C. C. A., 5th Circuit, pro-

mulgated July 25, 1941, *Dolores Crabb and others* v. *Commissioner.*

In the instant case not only did the ends of justice require that the question of worthlessness in 1932 be not considered, but equitable principles actually barred such consideration. The question as to whether Middle West stock might have become worthless prior to 1934 was specifically excluded by the deficiency determination. It was moreover an issue that could have been raised at any stage of the proceeding. It was in fact actually raised by other taxpayers and strenuously opposed by the Commissioner. To hold, under these circumstances, that the Board may on its own volition consider this issue, render decision on it, and do so without even giving petitioners an opportunity to put in evidence on this point, would be to go contrary to every Supreme Court decision that dealt with the subject of new issues.

III.

The failure to afford petitioners an opportunity to offer proof as to 1932 values, materially and injuriously affected the substantiality of the evidence necessary to sustain the finding of 1932 worthlessness.

In their appeal to the Circuit Court, petitioners also contended that the Board's decision was not supported by substantial evidence. So closely is this point related to the contention that petitioners did not receive a fair trial that it is deemed pertinent to briefly discuss it herein.

The Board found that both the common and preferred stock became worthless in 1932. To buttress its finding of 1932 worthlessness it stated that the record is replete with incidents and occurrences that

establish such worthlessness. It did not however, specify any of them. The Circuit Court could not find any such incidents or occurrences but presumed that the Board had in mind the 1932 receiverships of Middle West subsidiaries. This, however, the Court held did not establish worthlessness. On the contrary it reversed the Board on the holding that the evidence supported a finding of 1932 worthlessness for the preferred stock. In affirming the Board on the worthlessness of the common stock, that court disregarded all evidence other than the report of the receiver submitted in June 1933 which showed no book value for the common stock, resulting from the reserves set up by the accountants. But the fact is, that the reserves in question were set up not only for companies in receivership but also for investments in solvent, going concerns which never went into receivership.

Reserves, particularly those against companies not in receivership, are, after all, merely precautionary ear-markings against possible future losses. Present worthlessness is not to be predicated on the possibility of future losses. The companies are few indeed, that could not at the end of 1932 have set up sufficient reserves to wipe out all book value for the common stock.

The total of subsidiary companies in receivership to the end of 1932 was only $90,000,000 and to the end of 1933 only $100,000,000. Accordingly were it not for the reserves against the companies not in receivership, and assuming that the companies in receivership were a total loss, Middle West's book value would still have been over $200,000,000 leaving a sizeable equity for the common stock.

It is submitted that the question as to whether the Board's finding of 1932 worthlessness was supported

by substantial evidence is at best a very close one. The Board was certainly wrong as regards the preferred stock for there the Circuit Court held with petitioners. And, as stated, even there it was necessary for that court to resort to the accountant's statement (an item not even mentioned by the Board) to sustain the Board's holding as to the common stock. It is therefore not improbable but that had petitioners not been misled as to the absence of any worthlessness issue prior to 1934, they might have been able to establish that the reserves set up by the accountants were to a large extent precautionary, and that throughout 1932 and 1933 a book equity for the common stock actually existed.

Moreover, and even assuming that petitioners would have been unable to establish a 1932 or 1933 book equity for the common stock, they nevertheless might and undoubtedly would have been able to more definitely establish, that throughout this period there was every hope and expectation that something would be salvaged for the common stock, and thus establish value within the tests laid down by numerous cases. *Sterling Morton,* 38 B. T. A. 1270; *A. R. Jones Oil etc.* v. *Commissioner,* 114 Fed. (2) 642 at 646; *John W. Burdan* v. *Commissioner,* 106 Fed. (2) 207.

When it is considered that this court in the *Hormel* and *Richter* cases, held that due process of law required that the taxpayer be permitted to offer evidence before the Board, even though it felt that his chances were remote, how much more reason was it in the present instance, not to have deprived petitioners of their day in court on this question of 1932 worthlessness.

IV.

The Circuit Court's holding that a taxpayer must under all circumstances establish before the Board every essential fact involving in a deduction, is contrary to orderly procedure, imposes an undue burden on taxpayers, and presents a question that affects the public interest.

Aside from the particular question of due process of law involved in the instant proceeding, there is also involved the general question whether in a proceeding before the Board, a taxpayer must, regardless of the wording of the deficiency notice or the action of the Commissioner, prove every element of a deduction. This seems to be the holding of the Second Circuit in the instant case. A different holding was by the same court enunciated in the other cases Cf. *Taylor* v. *Commissioner,* 70 Fed. (2) 619 at 621; and *Moise* v. *Burnet,* 52 Fed. (2) 1071. Other courts hold with the *Taylor* and *Moise* cases. See *Chicago & N. W. Ry. Co.* v. *Commissioner,* 114 Fed. (2) 882 at 889; *Tex-Penn Oil Co.* v. *Commissioner,* 83 Fed. (2) 518, 524. The Board itself, has been inconsistent on this question (Cf. *John J. Seerley,* 43 B. T. A. 50, 57; *Carl M. Britt,* 43 B. T. A. 254 at 260), and may be further confused by the Circuit Court decision in the instant proceeding.

It is believed that the rule governing procedure before the Board as set forth by the Circuit Court in the instant proceeding is, as indicated not only in conflict with and contrary to the holding of other courts, but is in general disregard of the orderly rules of procedure and imposes an undue and improper burden on taxpayers.

In this connection attention may be called to the comments of Mr. Justice Frank of the Second Circuit in the recent case of *Knowlton Moore* v. *U. S.* decided June 24, 1941, as to the inequities of applying an inapplicable rule of procedure to retain a tax illegally collected.

As previously indicated, this court has felt it incumbent upon it to, and has actually passed on, the propriety of considering new issues raised for the first time in an appellate court. It has not apparently ever passed on the specific and important question, whether in the trial body, decision may be had on an issue not submitted to, or litigated before, such trial body, and under what circumstances a decision so predicated may be held to be proper. This question is constantly arising, particularly in proceedings before the Board of Tax Appeals and partakes of a public interest.

Conclusion.

For the above reasons, it is respectfully submitted that the decision below should be reviewed by this court, to the end that petitioners may be afforded an opportunity to present evidence on the issue on which the case was decided, that the rules of procedure be clarified and that justice in the premises be done.

HARRY FRIEDMAN,
538 Munsey Building,
Washington, D. C.,
Counsel for Petitioners.

Appendix A.

Section 23 of the Revenue Act of 1934 provides in part as follows:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME

"(In computing net income there shall be allowed as deductions:)

"(e) Losses by individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * * * * *"

Article 23 (e)-4 of Regulations 86 provides in part as follows:

"Shrinkage in value of stocks.—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under Section 113 is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. * * *"

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	4
Conclusion	6

CITATIONS

Cases:	
Bartlett v. *Commissioner*, 114 F. (2d) 634	5
Cass v. *Helvering*, 83 F. (2d) 841	5
Coleman v. *Commissioner*, 81 F. (2d) 455	5
Lambert v. *Commissioner*, 108 F. (2d) 624	5
Lucas v. *American Code Co.*, 280 U. S. 445	4
Squier v. *Commissioner*, 68 F. (2d) 25	5
Statute:	
Revenue Act of 1934, 48 Stat. 680, Sec. 23 (U. S. C., Title 26, Sec. 23)	2

414001—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 547

BENJAMIN MAHLER AND JULIA F. MAHLER,
PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 128–135) is reported at 119 F. (2d) 869. The unpublished memorandum opinion of the Board of Tax Appeals is printed in the record at pages 35 to 58, inclusive.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 6, 1941 (R. 135). The petition for a writ of certiorari was filed August 25, 1941.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in holding that the petitioners were not entitled in 1934 to deduct as a loss their investment in shares of common stock of Middle West Utilities Company.

STATUTE INVOLVED

Revenue Act of 1934, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) *Losses by individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or
>
> * * * * *

(U. S. C., Title 26, Sec. 23.)

STATEMENT

The petitioners are husband and wife, residents of the State of New York, where they filed a joint federal income tax return for the taxable year 1934 (R. 35–36).

During 1934 Benjamin Mahler was the owner of 1,300 shares of common stock in Middle West Utilities Company which had a cost basis to him of $24,144.32, and Julia F. Mahler was the owner of 65 shares of $6 cumulative preferred stock in Middle West Utilities Company which she had acquired in 1929 at a cost of $6,500 (R. 36). In their income tax return for the taxable year 1934 the petitioners deducted the cost of those shares as a loss, sustained within the taxable year (Ex. 7; see R. 119, 120). The deduction was disallowed by the Commissioner of Internal Revenue (R. 20, 25), and the petitioners appealed to the Board of Tax Appeals (R. 7–8).

On the basis of the evidence adduced at the hearing before it the Board of Tax Appeals held that the petitioners had failed to prove that any loss was sustained within the taxable year 1934 by reason of the preferred and common stock in Middle West Utilities having become worthless during the year 1934 and upheld the Commissioner's determination (R. 35–47, 58). It found affirmatively that the stock had become worthless in 1932 (R. 45).[1]

In its opinion the Circuit Court of Appeals reviewed the findings of the Board of Tax Appeals and held that the evidence sustained the finding

[1] Other issues raised before the Board of Tax Appeals and the Circuit Court of Appeals are not before the Court on the petition for certiorari.

of the Board that the common stock of Middle West Utilities became worthless prior to the taxable year 1934 (R. 128–134). The Circuit Court of Appeals concluded otherwise, however, with respect to the preferred stock of Middle West Utilities Company, holding that the evidence established the petitioners' right to deduct the cost of that stock as a loss sustained in 1934 (R. 134). It therefore affirmed the decision of the Board as to the common stock but reversed as to the preferred stock. The Government has not sought review of that portion of the decision relating to the preferred stock.

ARGUMENT

1. The only question now involved in this proceeding is whether the petitioners are entitled to deduct from their 1934 income, as a loss sustained in the taxable year,[2] the cost of certain shares of common stock in Middle West Utilities Company which they had acquired prior to the taxable year. Whether they are entitled to the deduction depends upon whether, as they contend, the stock became worthless during the taxable year.

Whether stock in a corporation became worthless during a particular year is a question of fact to be determined from the evidence adduced. And the question for decision by the Circuit Court of

[2] A loss can be deducted only for the year in which it is sustained. *Lucas* v. *American Code Co.*, 280 U. S. 445, 449.

Appeals is whether the findings of the Board are supported by substantial evidence.[3]

In this case the burden was upon the petitioners to prove that the stock which they owned in Middle West Utilities Company became worthless in 1934. From the evidence before it the Board found that the stock had become worthless prior to the taxable year. The Circuit Court of Appeals held that the evidence sustained the Board's findings with respect to the common stock, but held otherwise as to the preferred stock.

While there may be some doubt as to whether the Circuit Court of Appeals exceeded its authority in reversing the finding of the Board with respect to the preferred stock, it properly refused to disturb the Board's findings with respect to the common stock since, as outlined in the court's opinion, there was ample supporting evidence in the record.

2. Petitioners' central argument (Br. 13–25) is to the effect that they did not have to prove that the Middle West Utilities Company stock *became* worthless in 1934, the year they claimed the deduction, because the Commissioner, in disallowing the deduction, stated that the stock did not become worthless prior to the end of 1935. It is therefore

---

[3] *Coleman* v. *Commissioner*, 81 F. (2d) 455 (C. C. A. 10); *Cass* v. *Helvering*, 83 F. (2d) 841 (C. C. A. 8); *Squier* v. *Commissioner*, 68 F. (2d) 25 (C. C. A. 2); *Lambert* v. *Commissioner*, 108 F. (2d) 624 (C. C. A. 10); *Bartlett* v. *Commissioner*, 114 F. (2d) 634 (C. C. A. 4).

argued that the only burden imposed upon them was to prove that the stock was worthless in 1934. But this argument ignores the fact that the burden is upon the taxpayer in every case to establish his right to the deduction claimed, and the petitioners here had the burden, from the beginning, of showing that some event occurred *during* the taxable year which caused the stock to become worthless. The pivotal determination of the Commissioner was that there was no such event. Whether his determination was based on the subsidiary conclusion that the identifiable event was prior or subsequent to the taxable year was unimportant, for it was necessary for him to determine merely that it did not occur during the year in question.

CONCLUSION

The decision of the Circuit Court of Appeals is correct. The petition presents no question calling for review.

Respectfully submitted.

CHARLES FAHY,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
F. E. YOUNGMAN,
Special Assistants to the Attorney General.

SEPTEMBER 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1941